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Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551
Docket No. R–1442; RIN 7100–AD87

Re: Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action
Filed on August 30, 2012

Ladies and Gentlemen:

Day Pitney LLP appreciates the opportunity to provide comments on the joint notice of proposed rulemaking entitled *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action* (the "**NPR**" and, the proposed rule set forth therein, the "**Proposed Rule**") which was issued by the Office of the Comptroller of the Currency (the "**OCC**"), the Board of Governors of the Federal Reserve System (the "**Board**"), and the Federal Deposit Insurance Corporation (the "**FDIC**" and together with the OCC and the Board, the "**Agencies**"). Day Pitney LLP is an East Coast law firm with offices in Connecticut, Massachusetts, New Jersey, New York, and Washington, D.C. Many of the firm's clients are community banks that have issued trust preferred securities.

The purpose of this letter is to comment on the transition arrangements for depository institution holding companies with total consolidated assets of less than $15 billion as of December 31, 2009, which issued trust preferred securities. The transition provisions are found in Subpart G § 300(d) of the Proposed Rule.

I. Summary of the Proposed Rule Regarding Transition Arrangements for Trust Preferred Securities

Subpart G § 300(d) of the Proposed Rule provides that depository institutions currently may use non-qualifying capital instruments as tier 1 capital, but such instruments will be phased out from regulatory capital by either the accelerated phase-out of calendar year 2016 or the delayed phase-out of calendar year 2022.

The Proposed Rule distinguishes between depository institution holding companies ("**DHCs**") with total consolidated assets of $15 billion or more as of December 31, 2009 ("**DHCs with $15 billion or more**") and DHCs with total consolidated assets of less than $15 billion as of December 31, 2009 ("**DHCs under $15 billion**"). The Proposed Rule refers to a DHC that was a mutual holding company as of May 19, 2010 as a "**2010 MHC.**" The $15 billion cut-off date is derived from Section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").

Section 300(d)(1) of the Proposed Rule requires DHCs with $15 billion or more to phase out their trust preferred securities[1] by 2016. Section 300(d)(1)(iii) provides that if a DHC of $15 billion or more acquires a DHC under $15 billion or a 2010 MHC, the trust preferred securities of the resulting organization must be phased out by 2016. This makes sense because even if the target DHC was subject to the delayed phase-out, the acquiror expected to be subject to the accelerated phase-out. The acquisition should not change that result.

In contrast to Section 300(d)(1), Section 300(d)(2) allows DHCs under $15 billion to phase out their trust preferred securities by 2022. However, Section 300(d)(1)(iv) states that if a DHC under $15 billion makes an acquisition of a DHC under $15 billion or a 2010 MHC and the resulting organization has total consolidated assets of $15 billion or more at the date of acquisition, the resulting organization must phase out its trust preferred securities by 2016. This result, if read literally, does not make sense because the acquiror, before the acquisition, was never subject to the accelerated phase-out date. Therefore, the literal reading of Section 300(d)(1)(iv) will lead to the unintended and harmful consequence of discouraging acquisitions[2] by DHCs under $15 billion until the end of the delayed phase-out.

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[1] Henceforth, instead of using the general phrase "non-qualifying instruments," we will use "trust preferred securities" because they are a matter of key importance to our clients.

[2] The terms "merger" and "acquisition" are used interchangeably throughout this comment letter.

II. Both the Text of the Proposed Rule and the NPR's Explanation of the Proposed Rule Indicate That the 2016 Phase-Out Schedule Was Intended to Apply Only to Acquisitions Involving a DHC With $15 Billion or More, and Not to Acquisitions Involving Only DHCs Under $15 Billion

A. The Proposed Rule Is Inconsistent Because Section 300(d)(2) Does Not Recognize Section 300(d)(1)(iv) as an Exception From the 2022 Phase-Out Schedule For DHCs Under $15 Billion

Section 300(d)(1) of the Proposed Rule is the subsection that addresses DHCs with $15 billion or more. Section 300(d)(2) is the subsection that addresses DHCs under $15 billion. Section 300(d)(2) specifically recognizes Section 300(d)(1)(iii) as an exemption from the delayed phase-out schedule that applies to a DHC under $15 billion; pursuant to Section 300(d)(1)(iii), a DHC under $15 billion that is acquired by a DHC with $15 billion or more is subject to the accelerated 2016 phase-out schedule instead of the 2022 phase-out schedule.

In contrast, Section 300(d)(2) does not provide an exception that corresponds with Section 300(d)(1)(iv)—the subsection that addresses a situation where a DHC under $15 billion acquires another DHC under $15 billion. The lack of an exemption in Section 300(d)(2) that provides for the situation described in Section 300(d)(1)(iv) indicates that the 2016 phase-out schedule was not intended to apply to a situation where a DHC under $15 billion acquires another DHC under $15 billion; rather, Section 300(d)(2) indicates that each DHC under $15 billion in a merger is able to retain its 2022 phase-out schedule. This makes sense because separately, the two merging DHCs under $15 billion would not be subject to the 2016 phase-out schedule in the first place. A more logical reading is that the Proposed Rule in Section 300(d)(1)(iv) was meant to apply only to acquisitions which involve a DHC with $15 billion or more, in order to prevent the merging DHCs from circumventing the 2016 phase out schedule by having the DHC under $15 billion take the role of the acquiror.

To summarize, Section 300(d)(1) is inconsistent with Section 300(d)(2). Section (d)(2) authorizes DHCs under $15 billion to retain the delayed phase out until 2022 unless the DHC is acquired by an DHC of $15 billion or more. However, Section (d)(1)(iv) creates an exception that effectively over time guts the authorization provided in Section (d)(2), but the exception is not recognized in Section (d)(2).

B. The Text of the Proposed Rule is Inconsistent With the NPR's Explanation of the Proposed Rule

Further, the text of the Proposed Rule differs from the NPR's explanation[3] of the Proposed Rule. The Proposed Rule in Section 300(d)(1)(iv) discusses a situation where a DHC

[3] Page 97 of the NPR.

under $15 billion acquires another DHC under $15 billion. However, in the NPR, the last two sentences of the section entitled "Phase-out schedule for non-qualifying capital instruments of depository institution holding companies of $15 billion or more in total consolidated assets[4]" read as follows:

> . . . If a depository institution holding company of $15 billion or more acquires a depository institution holding company with total consolidated assets of less than $15 billion as of December 31, 2009 (depository institution holding company under $15 billion) or a depository institution holding company that was a mutual holding company as of May 19, 2010 (2010 MHC), the non-qualifying capital instruments of the resulting organization would be subject to the phase-out schedule outlined in table 20[5]. Likewise, if a depository institution holding company under $15 billion makes an acquisition and the resulting organization has total consolidated assets of $15 billion or more, its non-qualifying capital instruments would also be to the phase-out schedule outlined in table 20. (emphasis added)

The final sentence[6] of this section, in contrast with Section 300(d)(1)(iv) of the Proposed Rule, does *not* state that a DHC under $15 billion that acquires another DHC under $15 billion will be subject to the 2016 phase-out schedule. Instead, the sentence omits the requirement that the target DHC must be a DHC under $15 billion. Such an omission suggests that the 2016 phase-out schedule was not intended to apply to a situation where a DHC under $15 billion acquires another DHC under $15 billion.

Moreover, the use of the term "likewise" in the final sentence of the section is telling: The previous sentence states that when a DHC with $15 billion or more acquires a DHC under $15 billion, the resulting entity will be subject to the 2016 phase-out schedule. The use of "likewise" in the final sentence links the idea behind the two sentences together, which strongly suggests that the correct intent behind the NPR and Proposed Rule is that the 2016 phase-out schedule was meant to apply to acquisitions where at least one DHC is $15 billion or more, so as to prevent two merging DHCs from circumventing the 2016 phase out schedule by having the DHC under $15 billion take the role of the acquiror instead of the DHC with $15 billion or more.

In sum, the intent behind Section 300(d)(1)(iv) of the Proposed Rule appears from the NPR explanation to be that the 2016 phase-out schedule should apply only to acquisitions involving a DHC with $15 billion or more, not to acquisitions involving only DHCs under $15 billion. However, the Proposed Rule is contrary to this proposed intent.

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[4] *Id.*

[5] That is, the 2016 phase-out schedule.

[6] The sentence begins with "Likewise."

III. If the Proposed Rule in Section 300 (d)(1)(iv) Applies to All Mergers of DHCs Under $15 Billion When the Resulting Organization Exceeds $15 Billion, it Will Deter Mergers

Section 300(d)(1)(iv) of the Proposed Rule, if read literally, provides that when a DHC under $15 billion acquires another DHC under $15 billion which results in a new entity with assets of $15 billion or more, both DHCs lose the benefit of the 2022 phase-out schedule for their trust preferred securities. This means that if the two DHCs under $15 billion decide not to go through with the acquisition, each DHC will be able to retain its 2022 phase-out schedule. Thus, the Proposed Rule has the effect of penalizing DHCs under $15 billion that merge with other DHCs under $15 billion if the combined institution exceeds $15 billion; accordingly, the rule will deter acquisitions by DHCs under $15 billion that organically or by merger grow to have assets of $15 billion or more.

There is an abundance of situations that demonstrate the Proposed Rule's unintended harmful consequences for DHCs under $15 billion. For example, if a DHC with assets of $13 billion does well in its business and organically grows to have assets of $15 billion, it will then forfeit the 2022 phase-out schedule if it acquires any size institution. For the same reason, a DHC with assets of $12 billion or $13 billion will be deterred from significant mergers, since a merger likely would result in an entity with assets of $15 billion or more and thereby cause the DHC to lose its 2022 phase-out schedule. Finally, if a DHC with assets of $8 billion merges with another DHC with assets of $8 billion, the new entity's assets will be $16 billion—above the statutory requirement of $15 billion—and both DHCs will forfeit their 2022 phase-out schedules, which would be a significant factor weighing against such a merger of equals. In short, a literal reading of the Proposed Rule has the unintended effect of discriminating against those DHCs with assets under $15 billion by creating a disincentive for them to grow organically or merge with another DHC.

Furthermore, the years between 2013 and 2019 will experience the most severe impact; for example, if in the year 2016, a DHC under $15 billion acquires another DHC under $15 billion which results in a new entity with assets of $15 billion or more, the new entity will have no time whatsoever in which to phase out its trust preferred securities because all of its trust preferred securities are required to be phased out by 2016. As a consequence, DHCs under $15 billion will be especially reluctant to do any acquisitions in exactly the years when such acquisitions will be important.

IV. The Agencies Should Help DHCs Under $15 Billion Bear the Burden of Regulatory Compliance by Encouraging Mergers

While we do not argue with the Proposed Rule that all DHCs and depository institutions ought to phase out their trust preferred securities, the final rule should not penalize DHCs under $15 billion and deter such institutions from acquiring smaller community banks. Such community banks need to merge with one another in order to remain competitive in an ever-challenging market.

Due to the overwhelming burden of compliance costs, it is advantageous for DHCs under $15 billion to acquire a DHC or depository institution[7]. Such mergers are beneficial because they allow the resulting institution to spread increased compliance costs over a larger asset base. Accordingly, the Board has every reason to encourage—and not disincentivise—mergers.

However, the Proposed Rule presently *discourages* DHCs under $15 billion from acquiring other DHCs or depository institutions. If the Proposed Rule is adopted in its current form, it will have a chilling effect on community bank acquisitions, as a DHC under $15 billion has little incentive to do an acquisition that would cause it to forfeit the protection of the 2022 phase-out schedule.

As discussed in the NPR, the Agencies are well aware of the heavy compliance costs that smaller banking organizations face. Therefore, the Board has explained that it "has sought to incorporate flexibility and provide alternative treatments in this NPR . . . to lessen burden and complexity for smaller banking organizations wherever possible, consistent with safety and soundness and applicable law, including the Dodd-Frank Act[8]." The NPR then includes the extended phase-out schedule of 2022 in a list of examples of flexibility towards smaller banking organizations. Since the Proposed Rule allows DHCs under $15 billion to use the delayed 2022 phase-out schedule in transitioning out their trust preferred securities, the provision most consistent with that spirit of flexibility towards smaller banking institutions is one that permits any DHC under $15 billion, regardless of its acquisitions or natural growth, to continue to use the 2022 phase-out schedule.

V. Conclusion

The text of the Proposed Rule and the NPR indicate that the accelerated phase-out schedule was intended to apply to a DHC under $15 billion only when it merges with a DHC with $15 billion or more, which thereby prevents the DHC with $15 billion or more from circumventing the 2016 phase-out schedule by having the DHC under $15 billion act as the acquiror. Therefore, it makes sense that when two DHCs under $15 billion merge, the new entity should be subject to the 2022 phase-out schedule because each DHC qualifies on its own for the 2022 phase-out schedule. Consequently, this reading of the Proposed Rule will not discourage acquisitions by DHCs under $15 billion of smaller community banks, and will help alleviate the regulatory compliance burdens on smaller banking institutions.

A simple solution would be to revise Section 300(d)(iv) to require that one of the merging entities be a DHC with $15 billion or more at December 31, 2009.

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[7] Robin Sidel, 'Small Banks Put Up "For Sale" Sign,"' *The Wall Street Journal*, June 18, 2012, http://online.wsj.com/article/SB10001424052702303410404577468680797660956.html.

[8] Page 108 of the NPR.

We appreciate your consideration of our comments on the Proposed Rule. Please contact the undersigned if we can be of further assistance.

Respectfully submitted,

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